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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

NO. 999

PRESSED STEEL CAR COMPANY, INC., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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IN THE

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NO. ....

PRESSED STEEL CAR COMPANY, INC., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

The petitioner respectfully prays that a writ of certiorari issue to review a judgment of the United States Circuit Court of Appeals for the Third Circuit entered on December 26, 1945, affirming per curiam a decision of the Tax Court of the United States entered on August 16, 1944.

Summary Statement of the Matter Involved.

(a) THE PROCEEDINGS BELOW.

The opinion of the Tax Court of the United States was entered on August 16, 1944, and is not officially reported. The opinion of the Circuit Court of Appeals was entered on December 26, 1945, and is reported in 152 F. (2d) 280.

(b) THE FACTS OF THE CASE.

This case arises under Section 114(a) of the Revenue Act of 1936, as amended (49 Stat. 1686; 26 U.S.C.A., Internal Revenue Acts, pages 866 *et seq.*). Section 114(a) provides that the basis for the purpose of determining the amount of depreciation allowable as deduction in respect thereof shall be the adjusted basis provided in Section 113(b) of the Revenue Act of 1936 (26 U.S.C.A., Internal Revenue Acts, pages 859 *et seq.*), which latter section provides that such adjusted basis shall, in any case such as that in the case at bar, i.e., a taxable exchange, be the cost properly adjusted for events occurring after the date of the taxable exchange.

In 1936, petitioner, pursuant to a plan of reorganization under Section 77B of the Bankruptcy Act, acquired the assets of a corporation (hereinafter called the "predecessor") then being reorganized under the Bankruptcy Act. Petitioner acquired such assets of the predecessor by the issuance of certain of its securities to the reorganization trustees of the predecessor. Among the securities so issued was a substantial number (30,000) of shares of petitioner's Common Stock which, under the plan of reorganization, the reorganization trustees were required to turn over to an investment

syndicate as compensation for its services in participating in the reorganization.

Petitioner in its Federal income tax return for the taxable year ended December 31, 1936, claimed depreciation with respect to depreciable assets so acquired by it on the basis of an arbitrary value allocated by petitioner's Board of Directors to such depreciable assets and land. Such arbitrary value was the excess of the aggregate of petitioner's liabilities, capital and surplus accounts over the known value of all of its assets other than land and depreciable assets as recorded on its opening balance sheet. In such opening balance sheet the securities which petitioner issued in exchange for the assets of the predecessor corporation were stated at the par value thereof rather than their fair market value on the effective date of the reorganization, which fair market value was substantially higher than the par value and, in consequence, the value (i.e., the cost) allocated to depreciable assets was substantially less than it would have been if the fair market value of such securities rather than their par value had been used in the balance sheet. This resulted in petitioner claiming in its Federal income tax return a much smaller deduction for depreciation that it was entitled to claim under Section 23(n) of the 1936 Revenue Act.

Respondent determined a deficiency in petitioner's income tax liability for the taxable year ended December 31, 1936, in which he recalculated the amount of depreciation allowable as a deduction to the petitioner on the basis of the fair market values of the securities as determined by respondent, viz., $5 per share for petitioner's 5% Cumulative Convertible First Preferred Stock (herein called "First Preferred Stock"), $30 per share for

petitioner's 5% Convertible Second Preferred Stock (herein called "Second Preferred Stock") and $10 per share for petitioner's Common Stock.

On the effective date of the reorganization the common stock of petitioner's predecessor sold on the New York Stock Exchange at a low of $3 per share and a high of $3.25 per share and each share of such common stock of petitioner's predecessor became entitled to receive on the effective date of the reorganization ¼th share of petitioner's Common Stock. Petitioner's First Preferred Stock was convertible into petitioner's Common Stock on a share for share basis and petitioner's Second Preferred Stock was convertible into petitioner's Common Stock on the basis of three shares of Common Stock for each one share of Second Preferred Stock.

Respondent gave effect to the convertibility of petitioner's Second Preferred Stock into Common Stock by valuing Second Preferred Stock at exactly three times the value of the Common Stock but disregarded the convertibility of petitioner's First Preferred Stock into Common Stock on a share for share basis by determining that the value of petitioner's First Preferred Stock was only $5 per share, i.e., 50% of the value of petitioner's Common Stock on the effective date of the exchange.

Respondent also excluded from the cost of the land and depreciable properties acquired by the petitioner, the value of the 30,000 shares of Common Stock which petitioner issued to the reorganization trustees of the predecessor in exchange for the assets of such predecessor.

A Stipulation of Facts, which included the record of sales of the stock of petitioner's predecessor on the

New York Stock Exchange on the effective date of the reorganization and for several months before and after such date, was filed in the Tax Court proceedings and formed the principal part of the evidence before that Court. Included in such Stipulation of Facts were exhibits consisting of the Plan of Reorganization (Exhibit 2-B, R. 73 a-108 a) and the Order of the United States District Court for the Western District of Pennsylvania confirming the Plan of Reorganization (Exhibit 3-C, R. 109 a-141 a). The issuance of the 30,000 shares of petitioner's Common Stock to the reorganization trustees of the predecessor was provided by such Plan of Reorganization, *supra,* and Order Confirming the Plan of Reorganization, *supra.* Petitioner also introduced oral testimony of two expert witnesses who testified as to their opinion of the fair market value on the effective date of the reorganization of the securities, First Preferred Stock, Second Preferred Stock and Common Stock, issued by petitioner in exchange for the assets of the predecessor.

The Tax Court misunderstood the purpose for which the testimony as to the fair market value of the securities and the stipulated evidence as to the selling prices on the New York Stock Exchange of the predecessor's securities, which were convertible into petitioner's securities upon reorganization, were offered. The Tax Court erroneously supposed that the problem before it was to determine the fair market value of the assets for which petitioner exchanged its securities rather than to determine the fair market value of the securities which were issued in exchange for the assets.

In the Stipulation of Facts (R. 35 a-69 a) the respondent's method of determining how much of the fair

market value of the petitioner's securities issued in exchange for the predecessor's assets should be allocated as the cost of land and depreciable assets and the respondent's method of determining how much of such cost so determined should be allocated to each particular class of assets, viz., land, buildings, machinery and equipment, etc., were agreed to be correct.

Because of its fallacious assumption that the question presented to it was to determine the fair market value of the assets rather than the fair market value of the securities from which latter, by means of the concededly correct methods used by respondent (such methods being substantially the same as those used by petitioner in calculating its depreciation in its tax return) the cost of the depreciable assets could be calculated, the Tax Court completely ignored the only evidence which was before it as to the cost of the petitioner's depreciable assets and made its decision upholding the Commissioner's determination without the benefit of any evidence in the record which might conceivably support such decision.

The following excerpt from the opinion of the Tax Court (R. 276 a-277 a) clearly illustrates the Tax Court's complete misconception of the issue before it:

> "Petitioner asks us to fix the fair market value of the transferred assets at $12,500.00. This figure is based on the testimony of two 'expert witnesses' who arrived at their conclusions by various methods of stock valuation but is in no respect based on an appraisal of the physical assets sought to be depreciated. * * * Petitioner's case rests solely on the testimony of the two witnesses. In the process of valuation by petitioner's witnesses, there

was no attempt to segregate the values as to land, depreciable assets, or other assets, or to allocate to each class an appropriate value. The character of the physical assets and rates of depreciation were not taken into account. In fact, no attempt was made to value the specific properties in question. The witnesses were content to give their opinion of value of the stock without tying the same to any specific theory or mathematic process."

The net result of the Tax Court's misunderstanding of the issue, which the Circuit Court countenanced by affirming the decision, is that it deprives petitioner of the benefit of allowable depreciation deductions in computing its Federal income tax liabilities with respect to approximately $5,000,000 of the petitioner's investment (i.e., cost) for depreciable assets. For the taxable year ended December 31, 1936, the depreciation thus lost by reason of the Tax Court's misconception of the issue amounted to approximately $153,000.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, 43 Stat. 938 (28 U.S.C. 347(a)) and Section 1141 of the Internal Revenue Code, 53 Stat. 164 (26 U.S.C. 1141(a)).

Questions Presented.

1. Whether or not such part of the aggregate of the securities issued by a corporation in a taxable exchange for the assets of another corporation as are required by an agreement between the corporation receiving such securities and a third person to be turned over by the corporation receiving such securities to such third person for services in bringing about the exchange constitutes a part of the cost of the assets received in the exchange by the corporation issuing the securities.

2. Whether the Tax Court of the United States having before it stipulated evidence and testimony directly contradictory of a determination (in a formal notice of deficiency) made by the Commissioner of Internal Revenue, there being no other evidence in the record supporting such determination by the Commissioner of Internal Revenue, is entitled to give any evidentiary effect to such determination by the Commissioner of Internal Revenue.

3. Whether the Tax Court, having erroneously assumed that the question before it was one of determining the fair market value of the assets acquired in a taxable exchange on the date such exchange was effected rather than the real question of determining the cost of such assets, and having based its decision upon such misconception of the issue, has exceeded its authority under Section 1111 of the Internal Revenue Code, 53 Stat. 160 (26 U.S.C. 1111) in giving evidentiary effect to a determination of the Commissioner of Internal Revenue, and has thus so far departed from the accepted and usual course of judicial proceedings, which departure has been

sanctioned by the Circuit Court, as to call for an exercise of this Court's power of supervision.

Reasons Relied on for the Allowance of the Writ.

1. The decision of the Circuit Court, affirming the Tax Court, has decided a Federal question in a way which is in conflict with applicable decisions of this Court which hold that the cost of property purchased or acquired in a taxable exchange by a taxpayer is the fair market value of the consideration paid or given by the taxpayer for such property.

2. The decision of the Circuit Court, affirming the Tax Court, has decided a Federal question in a way which is in conflict with decisions of other circuit courts of appeal on the same matter in that the effect of its decision is that where the seller of property agrees to and does pay a commission out of the proceeds of the sale of property, the amount of such commission reduces the purchaser's cost of such property.

3. The decision of the Circuit Court, affirming the Tax Court, sanctioned such a departure from the accepted and usual course of judicial proceedings (in that such decision gives evidentiary effect to a determination of the Commissioner of Internal Revenue in the face of uncontradicted evidence and testimony contrary to the facts determined by the Commissioner of Internal Revenue, there being no other evidence in the record which supports or substantiates the facts determined by the

Commissioner of Internal Revenue) as to call for an exercise of this Court's power of supervision.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

NO. .....

PRESSED STEEL CAR COMPANY, INC., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Opinions Below.

The opinion of the Tax Court of the United States was entered on August 16, 1944, but is not officially reported. The opinion of the Circuit Court of Appeals was entered on December 26, 1945, and is reported at 152 F. (2d) 280.

Jurisdiction.

The judgment sought to be reviewed is a final judgment of the United States Circuit Court of Appeals for the Third Circuit affirming, without discussion, a decision of the Tax Court. The jurisdiction of this Honorable Court is invoked under Section 240(a) of the Judicial Code, as amended, 28 U.S.C. 347(a), and Section 1141 of the Internal Revenue Code, 26 U.S.C. 1141(a).

Statute Involved.

The statute involved is Section 114(a) of the Revenue Act of 1936, as amended, 49 Stat. 1686, 26 U.S.C.A., Internal Revenue Acts, p. 866 *et seq.*, and Section 113 of the Revenue Act of 1936, 49 Stat. 1686, 26 U.S.C.A., Internal Revenue Acts, page 859 *et seq.*

Statement.

The essential facts are summarized in the Petition for Certiorari under the title "Summary Statement of the Matter Involved", *supra,*

Specification of Errors.

The Circuit Court of Appeals erred as follows:

1. In holding that there is to be excluded from the basis of depreciation (i. e., the cost) of property in the hands of a purchaser that part of the price paid therefor by the purchaser which the seller had agreed to and did pay to a third party as compensation for services in negotiating the sale.

2. In holding that where there is substantial evidence before the Tax Court contradicting a determination in a final notice of deficiency of the Commissioner of Internal Revenue, the determination of the Commissioner of Internal Revenue may nevertheless be given evidentiary effect by treating it as evidence of the correctness of the facts set forth in such notice of deficiency.

3. In holding that where the opinion of the Tax Court conclusively shows that it did not understand the valuation issue before it and its opinion expressly states that its ruling on such issue is based on its mistaken understanding thereof, there was no substantial departure by the Tax Court from the accepted and usual course of judicial proceedings which should have been corrected by the Circuit Court.

Summary of Argument.

(a) The purchaser of depreciable property is entitled to depreciate the entire cost thereof. The fact that the seller of such depreciable property pays a part of the amount received by him as the purchase price therefor to a third party as a commission for services in negotiating the sale does not result in an equivalent reduction in the purchaser's cost (i. e., the purchase price) of such property.

(b) The presumption of correctness accorded to a determination made in a formal notice of deficiency by the Commissioner of Internal Revenue in a proceeding before the Tax Court is destroyed when substantial evidence is introduced that the facts so determined by the Commissioner of Internal Revenue are incorrect and no

evidentiary effect can thereafter be given to such determination.

(c) The Circuit Court sanctioned a departure by the Tax Court from the accepted and usual course of judicial proceedings which gravely and seriously affected petitioner in that it deprived petitioner of the right to depreciate more than $5,000,000 of its investment in depreciable assets. Such departure resulted from its plainly disclosed misunderstanding of the issue presented to it for decision.

ARGUMENT.

I.

The Decision of the Circuit Court Is in Conflict with Applicable Decisions of This Court.

The decision of the Circuit Court affirming that of the Tax Court is clearly in conflict with the decision of this Court in *Detroit Edison Co. v. Commissioner of Internal Revenue,* 319 U. S. 98, 63 S. Ct. 902 (1943).

The facts relating to the securities issued by petitioner to its predecessor in exchange for the assets of such predecessor are not in dispute, all such facts having been stipulated before the Tax Court. The petitioner issued 268,706.9 shares as well as other securities to the reorganization trustees of the predecessor in exchange for the assets of such predecessor and also assumed certain liabilities. The Plan of Reorganization contained an agreement between the reorganization trustees and an investment syndicate headed by General American Transportation Corporation that the reorganization trustees would, as compensation for the services of the

investment syndicate in connection with the reorganization if the Plan of Reorganization was confirmed, deliver 30,000 of the 268,706.9 shares of such Common Stock to be received by the reorganization trustees to the investment syndicate. The Plan was confirmed and the securities mentioned were delivered to the reorganization trustees in exchange for the assets. The reorganization trustees thereupon turned over the 30,000 shares of Common Stock to the investment syndicate. In determining petitioner's basis for depreciation which, under Sections 114(a) and 113(b) of the 1936 Revenue Act (26 U.S.C.A., Internal Revenue Acts, Pages 859, 866), was the cost of acquiring such depreciable assets, the Commissioner excluded from such cost the fair market value, on the effective date of the reorganization, of such 30,000 shares of petitioner's Common Stock. The Tax Court sustained the Commissioner in excluding such amount from the cost of the depreciable assets so acquired and the action of the Tax Court was affirmed by the Circuit Court. This Court in *Detroit Edison Co. v. Commissioner, supra,* defined "cost" as meaning the amount paid to acquire property. The fact that a commission may be paid by the seller of property to the broker or other person who negotiated the sale or participates in the sale cannot under the decision of this Court be applied in reduction of a purchaser's outlay. Whatever the purchaser pays to the seller constitutes the purchaser's cost.

II.

The Decision of the Circuit Court Is in Conflict with Applicable Decisions of Other Circuit Courts of Appeals on the Same Matter.

The decision of the Circuit Court which affirmed the decision of the Tax Court rules that where a commission is paid by the seller of property out of the purchase price paid by the purchaser for such property, the amount of such commission reduces the cost incurred by the purchaser in acquiring such property. This decision of the Circuit Court is in direct conflict with *Commissioner v. Schumacher Wall Board Corp.*, 39 F.(2d) 79 (C.C.A. 9, 1937) and *Champlin Refining Company v. Commissioner*, 123 F.(2d) 202 (C.C.A. 10, 1941). The decision of the Circuit Court is also in direct conflict with its own previous decisions in *Forstmann v. Rogers*, 128 F.(2d) 126 (C.C.A. 3, 1937) and *Hazeltine Corporation v. Commissioner*, 89 F. (2d) 513 (C.C.A. 3, 1937).

The principal issue in *Commissioner v. Schumacher Wall Board Corporation, supra,* was the determination of the basis for depreciation (i.e., the cost) of certain assets. Schumacher Wall Board Corp. (herein called Schumacher) issued all of its stock to Corporation A in consideration for the transfer to Schumacher of all of the assets of Corporation A plus the agreement of Corporation A to cause certain patents, which did not then belong to Corporation A, to be assigned to Schumacher. Such patents were owned at the time by the Corporation A stockholders. Such stockholders agreed to sell their patents and all of the stock in Corporation A to Corporation B for approximately $1,500,000 in cash. When Corporation A received the Schumacher stock it

immediately transferred such stock to Corporation B as consideration for the execution and delivery to Corporation A of Corporation B's promissory note and an agreement by Corporation B to transfer the patents which now belonged to Corporation B to Schumacher. By virtue of these agreements relating to the transfer of the patents, the patents were transferred to Schumacher when Corporation B paid the above-mentioned $1,500,000. Corporation A then dissolved and in the course of its liquidation Corporation B's promissory note was returned to Corporation B. Immediately after Corporation B had received all of the stock of Schumacher, it transferred a substantial part of that stock to three other corporations, C, D and E, pursuant to a pre-arranged plan. The net result of these various steps was that Schumacher had the patents and owned all of the assets of Corporation A and Corporation B and Corporations C, D and E owned all of the Schumacher stock. The Commissioner claimed that since the stockholders of Corporation A, who had owned the patents involved, transferred those patents directly to Schumacher, the cost of such patents was the amount which Corporation B had paid to such stockholders for the patents. The Circuit Court of Appeals for the Ninth Circuit held that the cost of the patents to Schumacher was the value of the stock which it had issued in exchange therefor.

In *Champlin Refining Co. v. Commissioner, supra,* the Circuit Court of Appeals for the Tenth Circuit held that "where property is given in exchange for other property, the cost of the property acquired is the value of the property given in exchange therefor." In the instant case the Tax Court made no effort to determine the value of the property (i.e., its securities) given by peti-

tioner in exchange for the assets of its predecessor, although there was substantial evidence in the record as to the value of such securities.

In *Hazeltine Corp. v. Commissioner, supra,* and *Forstmann v. Rogers, supra,* the Circuit Court of Appeals for the Third Circuit held specifically that the cost of property is the amount paid by the purchaser to the seller notwithstanding any disposition which the seller may make of the amount so received to other persons.

III.

The Decision of the Circuit Court Sanctions Such Departure from the Accepted and Usual Course of Judicial Proceedings as to Call for an Exercise of This Court's Power of Supervision.

The Tax Court had before it a stipulation of facts which included evidence as to sales on the New York Stock Exchange of securities which were freely convertible into the securities issued by petitioner in exchange for its assets. The Tax Court also had before it expert testimony as to the fair market value of the petitioner's securities which were so issued. The Tax Court erroneously supposed that the issue presented to it was one requiring the determination of the fair market value, on the effective date of the reorganization, *of the assets which the predecessor transferred to the petitioner rather than the determination of the fair market value of the property (i.e., the securities) which the petitioner transferred to its predecessor in exchange for the predecessor's assets.* This admits of no dispute because, as is

pointed out above, the opinion of the Tax Court expressly states that it was asked "to fix the fair market value of the transferred assets". The Tax Court also expressly declared that it was not required to give any weight to the testimony of the expert witnesses because they did not attempt to express an opinion as to the fair market value of the assets transferred to the petitioner. The Tax Court made no comment whatever about the evidence as to the fair market value of petitioner's securities which was afforded by the selling price on the New York Stock Exchange of other securities which were freely convertible into petitioner's securities, and has clearly ignored that evidence completely. The evidence of the New York Stock Exchange sales, as well as the evidence afforded by the testimony of the expert witnesses, was in direct conflict with the determination made by the Commissioner of Internal Revenue in his formal notice of deficiency. There was no other evidence in the record to support the determination so made by the Commissioner of Internal Revenue. The effect of the Tax Court's action in disregarding entirely the evidence of the New York Stock Exchange sales and the testimony of the expert witnesses was to give to the determination of the Commissioner of Internal Revenue the force and effect of evidence. It is well-established that the presumption of correctness which attaches to the determination by the Commissioner of Internal Revenue in a notice of deficiency is destroyed when evidence contradicting or showing the incorrectness of his determination is introduced in evidence: *J. M. Perry & Co., Inc., v. Commissioner*, 120 F. (2d) 123 (C.C.A. 9, 1941); *Mertens, Law of Federal Income Taxation* (1943), Vol. 9, Sections 50.69, 50.71.

As a result of its misapprehension as to the nature of the issue presented to it, the Tax Court's decision was made without regard to the uncontradicted evidence which related to the fair market value of the securities which petitioner issued in exchange for its predecessor's assets. The appropriate method of determining the cost of such assets was to determine the value of the property (securities) that the petitioner gave in exchange for such assets. Since there was evidence of such value, the Tax Court was bound to consider it, but because it thought that the dispute between the petitioner and the Commissioner of Internal Revenue related to the value of the assets at the time of the exchange rather than the amount paid therefor by the petitioner, it departed widely from the usual and accepted course of judicial proceedings, which departure should have been corrected by the Circuit Court. It is clear from the record of the proceedings below (R. 6 a, 8 a) that the effect of the Tax Court's deviation from the usual and accepted course of judicial proceedings will be to deprive petitioner of the advantage of deductions for depreciation in computing its Federal tax liabilities with respect to more than $5,000,000 of its investment in its depreciable properties and, for the taxable year ended December 31, 1936, deprives the petitioner of a deduction for depreciation in excess of $152,000.

Such departure from the accepted and usual course of judicial proceedings should not be countenanced by this Court.

Respectfully submitted,

PRESSED STEEL CAR COMPANY, INC.
Petitioner,

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 999

PRESSED STEEL CAR COMPANY, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The Tax Court entered memorandum findings of fact and opinion (R. 255a–282a) which are not reported. The opinion of the Circuit Court of Appeals affirming the decision of the Tax Court *per curiam* (R. 284) is reported at 152 F. 2d 280.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 26, 1945. (R. 285–286.) The petition for a writ of certiorari was filed March 26, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial

Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the Tax Court erred in determining the basis for depreciation of assets acquired by the taxpayer in exchange for its securities.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and

obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

STATEMENT

The taxpayer was incorporated on July 24, 1936 (R. 256a), pursuant to a plan of reorganization of Pressed Steel Car Company of New Jersey in proceedings under the provisions of Section 77 B of the Bankruptcy Act. (R. 73a, 78a, 121a–122a). The plan (R. 73a–108a) and the order of the District Court confirming the plan (R. 109a–141a) provided in detail the successive steps and the securities required for its consummation. The order directed the old company and the trustees appointed in the bankruptcy proceedings to transfer to the taxpayer all of the properties and assets of the old company and directed that the taxpayer issue and deliver to the trustees the new securities in accordance with the terms and provisions of the plan. (R. 258a–259a.)

The plan of reorganization contemplated the acquisition of from $1,750,000 to $2,150,000 of new money to be used for working capital and other purposes. The stockholders were given the opportunity to furnish all or a part of the new money. If they should fail to do so, the General American Transportation Company had agreed to take not less than 350,000 shares of the first pre-

ferred stock of the new company at $5 per share. (R. 258a.) This agreement was embodied in the plan, together with the provision that as compensation for so undertaking to finance the reorganization of the company to the extent of at least $1,750,000, General American and its associates were entitled to receive 30,000 shares of the common stock of the new company, the taxpayer. (R. 82a–83a, 103a, 107a.)

On July 29, 1936, pursuant to the confirmation order, the taxpayer issued and delivered its debentures, second preferred stock, and common stock in temporary certificate form to the trustees, and they in turn transferred all of the assets, except $750,000 in cash, to the taxpayer. (R. 263a.) General American paid $1,750,000 to the trustees, and on October 14, 1936, the taxpayer issued and delivered to General American 350,000 shares of first preferred stock. (R. 264a–265a.)

The securities delivered by the taxpayer to the trustees, General American, and security holders on July 29, 1936, pursuant to the plan, were valued by the Commissioner at $6,985,130.20. The Tax Court found that such value was the cost basis of property acquired by the taxpayer, which issued its stock therefor,[1] and that in that

[1] The Tax Court held, contrary to the Commissioner's contention, that this exchange was not a tax-free reorganization, and therefore that the basis of the assets acquired by the taxpayer must be determined from this exchange. (R. 271a–281a.)

cost the Commissioner did not include the 30,000 shares of new common stock delivered by the taxpayer to the trustees who transferred them to General American. (R. 271a.) Of the sum of $6,985,130.20, the Commissioner allocated $4,195,286.54 to depreciable assets and land, and $2,788,840.66 to other assets. (R. 271a.) The method of allocation is not contested. (R. 50a–51a, Pet. 6.) The depreciable assets transferred to the taxpayer by the predecessor company on July 29, 1936, consisted of buildings, equipment and machinery, office furniture, patterns, templates and dies, which were set up on its books at certain values. (R. 271a–272a.)

The taxpayer recorded the depreciable assets and land so acquired on its books as follows (R. 272a):

Land:	
McKees Rocks	$340,742.75
Allegheny	163,537.01
Buildings:	
McKees Rocks	1,166,562.12
Allegheny	20,698.29
Machinery:	
McKees Rocks	2,204,124.36
Allegheny	20,698.29
Furniture	57,709.81
Drawings	102,828.76
Patterns	41,131.51
Templates	12,339.45
Dies	174,955.33
Improvements on Leased Property:	
Buildings	305,125.87
Machinery & equipment	114,342.29
	$4,784,795.84

In its tax return for the year 1936 the taxpayer deducted $136,714.56 as depreciation. In the notice of deficiency the Commissioner allowed a deduction of $132,727.85 (R. 272a.) By amended petition for redetermination in the Tax Court, the taxpayer claimed an increased deduction for depreciation in the amount of $285,377.13 (R. 6a, 275a) based upon an alleged fair market value of the transferred assets of $12,500,000 (R. 276a). The Tax Court sustained the allowance for depreciation on the basis of the original notice of deficiency. (R. 276a–277a.)

ARGUMENT

Contrary to the taxpayer's assertion (Pet. 5–7, 8, Br. 13, 18, 20) the Tax Court did not misapprehend the issue before it in determining the basis for depreciation of the depreciable assets acquired by the taxpayer from its predecessor. As the taxpayer states (Pet. 6, 8, Br. 15–18) their basis for depreciation, disregarding provisions for adjustments not here relevant, is their cost. Revenue Act of 1936, Sec. 114 (a), *supra*. The Tax Court found that the securities which were delivered over on July 29, 1936, by the taxpayer pursuant to the plan of reorganization were valued by the Commissioner at $6,985,130.20, and "Such value was the cost basis of property acquired to the petitioner, which issued its stock therefor, * * *" (R. 271a.) This finding hardly leaves room for the taxpayer's assertion

that the Tax Court mistook the question to be the fair market value of the assets received by the taxpayer (Pet. 6–7, Br. 18–19), and the stipulation of facts (R. 49a–51a) left no room for any question as to the issues between the parties.[2] Nor is that assertion in any way strengthened because the Commissioner and the courts below excluded, in computing the cost to the taxpayer of its assets, 30,000 shares of stock issued by the taxpayer for delivery to General American. (Pet. 8–9, Br. 12, 15–16.) As the Tax Court found, these were excluded from cost (R. 271a), because they represented, not the cost of assets acquired by the taxpayer, but value paid by the taxpayer for the expenses of its organization. (R. 276a.)

The taxpayer does not claim that the expenses of its organization should go to increase the cost or depreciation basis of its assets, nor do the cases cited by the taxpayer so hold. (Br. 14–18.) Those cases hold only that where securities or property are in fact exchanged for assets, the cost of the assets is the fair market value of the property given up in exchange. The substance of the petition is that the Tax Court should have treated the

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[2] The value of the assets, however, was relevant in determining the value of the stock and the petitioner contended that the value of the assets was at least $12,500,000, the value which it placed on the securities. The excerpt from the opinion quoted in the petition (pp. 6–7) is to be interpreted in the light of this contention which the Tax Court was answering.

30,000 shares as part of the cost of the assets, rather than a cost of organization, and should have found a different value for the securities which the taxpayer issued. (Br. 18–20.) But the classification of the payment in shares and the determination of value are questions of fact. Cf. *John Kelley Co.* v. *Commissioner,* decided by the Court January 7, 1946, not yet reported; *Elmhurst Cemetery Co.* v. *Commissioner,* 300 U. S. 37. The treatment of the shares as payment of an organization expense is amply warranted by the plan of reorganization and the order confirming the plan (R. 82a–83a, 107a, 121a, 133a), for the 30,000 shares were compensation to General American and its associates for "undertaking to finance the reorganization of the Company to the extent of at least $1,750,000 * * *" which sum was to provide new money for working capital (R. 82a). The depreciation allowed by the Commissioner and affirmed by the Tax Court is substantially in line with the depreciation claimed on the taxpayer's returns, and the valuations used are substantially in line with those ascribed to the taxpayer's shares on its books. (R. 272a, 276a.) For reasons made clear in its opinion the Tax Court found the valuation evidence adduced by the taxpayer to be unpersuasive. (R. 276a–277a.) The Circuit Court of Appeals affirmed the Tax Court's decision *per curiam* (R. 284), obviously because the questions

presented by the taxpayer's appeal were beyond the scope of appellate determination. *Dobson* v. *Commissioner,* 320 U. S. 489.

CONCLUSION

The petition presents no substantial question and should be denied.

Respectfully submitted.

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